



WHAT IS PORTFOLIO TURNOVER RATIO?

THE EQUITY COMPASS

EDITION
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Understanding how actively a mutual fund's portfolio is bought and sold.

Imagine a chef planning a restaurant menu.

One chef changes the menu frequently as customer preferences, ingredient prices, and seasonal availability change. Another retains most dishes for longer, making changes only when necessary.

Neither approach is automatically better. Frequent changes may help the restaurant respond quickly, but they also require more effort and may increase costs. Fewer changes may reflect consistency, but retaining an unsuitable dish for too long may also be unhelpful.

A mutual fund portfolio can be viewed in a similar way.

Some fund managers buy and sell securities more frequently, while others hold investments for longer periods. The Portfolio Turnover Ratio helps investors understand the extent of this activity.



WHAT IS PORTFOLIO TURNOVER?

Portfolio turnover refers to the amount of buying and selling that takes place within a mutual fund scheme's portfolio over a specified period.

The Portfolio Turnover Ratio, commonly referred to as the PTO Ratio, measures this activity relative to the scheme's average assets under management.

It indicates how actively the portfolio has changed, but does not explain whether those changes created value.



HOW IS THE PTO RATIO CALCULATED?

In Indian mutual fund disclosures, the Portfolio Turnover Ratio is commonly calculated as:

$$\text{Portfolio Turnover Ratio} = \frac{\text{Lower of Purchases or Sales}}{\text{Average Assets Under Management}}$$

The ratio is calculated for a specified period, commonly the last twelve months, and may be expressed as a percentage or in times.

Hypothetical example

Consider an equity mutual fund with:

Particulars	Amount
Average assets under management	₹100 crore
Securities purchased during the period	₹70 crore
Securities sold during the period	₹50 crore

The lower of purchases and sales is ₹50 crore.

$$\text{PTO Ratio} = \frac{\text{₹50 crore}}{\text{₹100 crore}} = 0.50 \text{ times, or } 50\%$$

This means that the turnover measured under the PTO formula was equal to 50% of the fund's average AUM during the period.

It does not necessarily mean that half of the fund's individual securities were replaced, as the same security may be traded more than once.



HOW TO READ THE PTO RATIO

PTO RATIO	WHAT IT MAY SUGGEST
Relatively low	The portfolio may follow a longer holding period with fewer changes
Relatively high	The portfolio may be repositioned more actively
Rising over time	The fund manager may be responding to changing opportunities, risks, or market conditions
Falling over time	The portfolio may be becoming more stable

There is no universal level that can be considered ideal. The ratio should be understood in the context of the scheme's investment objective, category, strategy, and prevailing market conditions.



WHY CAN PORTFOLIO TURNOVER INCREASE?

Portfolio turnover may rise for several reasons:

- Changes in the fund manager's view of a company or sector
- Rebalancing in response to market movements
- Changes in earnings expectations or business fundamentals
- Risk-management decisions
- Valuation-based buying or selling
- Adjustments required to maintain the scheme's investment strategy

A higher ratio may therefore reflect active investment decisions. However, frequent trading can also lead to higher brokerage and transaction costs.

The key question is not simply how often the portfolio changed, but whether those changes were consistent with the scheme's strategy and supported its risk-return objective.



POINTS TO KEEP IN MIND

- The PTO Ratio measures portfolio activity, not investment performance.
- A higher ratio may involve greater transaction costs, but it may also reflect necessary portfolio decisions.
- A lower ratio may indicate longer holding periods, but does not guarantee better outcomes.
- The ratio can change as market conditions and investment opportunities evolve.
- It should be compared across similar schemes and reviewed over multiple periods.
- It is best interpreted alongside performance consistency, risk, expense ratio, investment style, and portfolio composition.

The Portfolio Turnover Ratio tells investors how actively a portfolio has changed. Understanding why it changed is more important than viewing the number in isolation.